(1)

Supreme Court, U.S.
FILED

97 . 271 AUG 1 2 1997
No. _____

OFFICE OF THE CLERK

In The

Supreme Court of the United States

October Term, 1996

In re

JAMES DELBERT McCONVILLE, and CLARA MAE McCONVILLE DBA McCONVILLE ENTERPRISES,

Debtors.

TEVIS T. THOMPSON, JR., TRUSTEE IN BANKRUPTCY FOR JAMES DELBERT McCONVILLE AND CLARA MAE McCONVILLE,

Petitioner,

v.

DAVID MARGEN AND LAWTON ASSOCIATES,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

IRVING J. KORNFIELD, Esq. (Bar No. 033880)
Counsel of Record
CHARLES NOVACK, Esq. (Bar No. 127776)
KORNFIELD, PAUL & BUPP, P.C.
1999 Harrison Street, Suite 800
Oakland, California 94612
Telephone: (510) 763-1000

Attorneys for Tevis T. Thompson, Jr., Trustee in Bankruptcy for James Delbert McConville and Clara Mae McConville, Petitioner

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

63 pp

QUESTIONS PRESENTED

1. Under section 549(a) of the Bankruptcy Code[1], a trustee may avoid an unauthorized, post-petition transfer of property of the bankruptcy estate. Under section 101(54) of the Bankruptcy Code, a "transfer" is broadly defined, and includes every mode of disposing or parting with property or an interest in property, including retention of title as a security interest in property. After the debtors filed their bankruptcy, debtors granted an unauthorized security interest to respondents in property of their bankruptcy estate. The first question presented here is: Is the post-petition granting of a security interest in property of the bankruptcy estate a "transfer" under section 549(a)?

2. Even though the Ninth Circuit Court of Appeals refused to apply Bankruptcy Code section 549 to the transaction, it held that the post-petition financing violated Bankruptcy Code section 364. However, the Court awarded respondents a lien against the estate property on the theory that the transaction could be rescinded, although respondents had *never* sought nor argued for rescissionary relief. The second question presented is: (a) should a transferee of a transfer avoidable under the Bankruptcy Code be allowed to retain the benefit of the transfer by rescinding the transaction and (b) where that equitable relief had never been requested by the transferee or argued to any court, should the Court of Appeals have granted the relief in the first instance, instead of remanding the case to the trial court for trial on the factual issues?

---

[1] All references to the Bankruptcy Code are to 11 U.S.C.

TABLE OF CONTENTS

Page

QUESTIONS PRESENTED i

OPINIONS BELOW 1

JURISDICTION 2

STATUTES INVOLVED IN THIS CASE 2

STATEMENT OF THE CASE 4

REASONS FOR GRANTING THE WRIT 8

I. THE NINTH CIRCUIT'S OPINION DIRECTLY CONFLICTS WITH THE DECISION OF THE SECOND CIRCUIT IN *IN RE PHOTO PROMOTION ASSOCIATES, INC.* AND THE FIFTH CIRCUIT IN *IN RE POINTER* AND CONTRADICTS THE EXPRESS LANGUAGE OF SECTION 101(54) OF THE BANKRUPTCY CODE 8

II. IN ALLOWING A TRANSFEREE OF AN AVOIDABLE TRANSFER TO RETAIN THE BENEFIT OF HIS TRANSFER BY AFFORDING THE EQUITABLE REMEDY OF RESCISSION, NOTWITHSTANDING A CLEAR VIOLATION OF THE BANKRUPTCY CODE, THE NINTH CIRCUIT HAS GRANTED A REMEDY NOT PROVIDED FOR IN THE BANKRUPTCY CODE, OPENING A POTENTIAL FLOOD OF LITIGATION BY FUTURE DEFENDANTS IN BANKRUPTCY CASES 10

III. THE NINTH CIRCUIT EXCEEDED ITS AUTHORITY IN GRANTING RESCISSION WHEN IT HAD NOT BEEN SOUGHT, INSTEAD OF REMANDING THE MATTER TO THE TRIAL COURT FOR DETERMINATION 12

CONCLUSION 14

TABLE OF CONTENTS – Continued

Page

APPENDIX

A. Ninth Circuit Order and Opinion filed March 26, 1997 (Withdrawing Amended Opinion) 1a

B. Ninth Circuit Order and Amended Opinion filed September 26, 1996 (Amending Opinion of 5/21/96) 1a

C. Ninth Circuit Opinion filed May 21, 1996 ..... 1c

D. District Court Order Affirming the Bankruptcy Court's Judgment filed December 23, 1994 ..... 1d

E. Bankruptcy Court Findings of Fact and Conclusions of Law filed April 22, 1994 ..... 1e

F. Bankruptcy Court Judgment Avoiding Transfer filed April 22, 1994 ..... 1f

G. Order Denying Petition for Rehearing filed May 27, 1997 ..... 1g

TABLE OF AUTHORITIES

Page

CASES

Grella v. Salem Five Cent Savings Bank, 427 F.3d 26 (1st Cir. 1994) 9

Hormel v. Helvering, 312 U.S. 552, 61 S.Ct. 719, 85 L.Ed. 1037 (1941) 13, 14

In re McConville, 110 F.3d 47 (9th Cir. 1997) 1

In re McConville, 97 F.3d 316 (9th Cir. 1996) 1

In re McConville, 84 F.3d 340 (9th Cir. 1996) 1

In re Melon Produce, Inc., 976 F.2d 71 (1st Cir. 1992) 9

In re Photo Promotion Associates, Inc., 881 F.2d 6 (2nd Cir. 1989) 8, 11

In re Pointer, 952 F.2d 82 (5th Cir. 1992).....8, 9

Singleton v. Wulff, 428 U.S. 106, 96 S.Ct. 2868, 49 L.Ed. 2d 826 (1976).....13, 14

Sullivan v. Stroop, 496 U.S. 478, 110 S.Ct. 2499, 110 L.Ed. 2d 438 (1990)..... 10

U.S. v. Ron Pair Enterprises, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed. 2d 290 (1989)..... 9

STATUTES AND RULES

28 U.S.C. § 157..... 7

28 U.S.C. § 158(a) 7

28 U.S.C. § 1254(1) 2

28 U.S.C. § 1291..... 7

28 U.S.C. § 1334..... 7

TABLE OF AUTHORITIES – Continued

Page

Bankruptcy Code § 101(54) 2, 8, 9
Bankruptcy Code § 362(a) 2
Bankruptcy Code § 362(a)(4) 6
Bankruptcy Code § 364 6
Bankruptcy Code § 364(c) 3, 7, 8
Bankruptcy Code § 364(c)(2) 11
Bankruptcy Code § 503(b) 8
Bankruptcy Code § 544 10
Bankruptcy Code § 547 ..... 9, 10, 11
Bankruptcy Code § 547(c) 11
Bankruptcy Code § 548 10
Bankruptcy Code § 549 ..... 3, 7, 8, 9, 10
Bankruptcy Code § 549(a) 5, 6, 7, 8
Bankruptcy Code § 549(c) 5, 6, 12
Supreme Court Rule 13.3 2

PETITION FOR WRIT OF CERTIORARI

Tevis T. Thompson, Jr., trustee in bankruptcy of James Delbert McConville and Clara Mae McConville ("Petitioner"), respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on March 26, 1997, in order to resolve a conflict between the Ninth Circuit Court of Appeals, on the one hand, and the Second and Fifth Circuit Courts of Appeals, on the other, with respect to the important issue presented herein. The writ is further sought to have this Court exercise its supervisory power to correct a departure by the Ninth Circuit Court of Appeals from the accepted and usual course of judicial proceedings.

OPINIONS BELOW

The citation for the opinion of the United States Court of Appeals for the Ninth Circuit that gives rise to this petition (App. *infra* A) is *In re McConville*, 110 F.3d 47 (9th Cir. 1997). This opinion replaced a prior order and amended opinion of the Ninth Circuit (App. *infra* B), the citation of which is *In re McConville*, 97 F.3d 316 (9th Cir. 1996). The Ninth Circuit's initial order and opinion in this matter (App. *infra* C) may be found at *In re McConville*, 84 F.3d 340 (9th Cir. 1996). The judgment of the district court (App. *infra* D) is unreported, as were the findings and judgment of the bankruptcy court (App. *infra* E and F).

JURISDICTION

On March 26, 1997, the United States Court of Appeals for the Ninth Circuit entered its order and opinion from which Petitioner seeks review. The Ninth Circuit thereafter denied Petitioner's timely petition for rehearing with suggestion for rehearing *en banc* by order filed on May 27, 1997 (App. *infra* G). Pursuant to Supreme Court Rule 13.3 this petition has been filed within 90 days of the denial of the petition for rehearing.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED IN THIS CASE

Bankruptcy Code § 101(54) provides, in part, as follows:

"In this title – . . .

(54) 'transfer' means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption."

Bankruptcy Code § 362(a) provides, in part, as follows:

> "(a) Except as provided in subsection (b) of this section, a petition filed under § 301, 302 or 303 of this title . . . operates as a stay, applicable to all entities, of . . . (4) any act to create, perfect or enforce any lien against property of the estate . . . "

Bankruptcy Code § 364(c) provides, in part, as follows:

"(c) If the Trustee is unable to obtain unsecured credit allowable under section 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining of credit or the incurring of debt – . . . (2) secured by a lien on property of the estate that is not otherwise subject to a lien . . . "

Bankruptcy Code § 549 provides, in part, as follows:

"(a) Except as provided in subsections (b) or (c) of this section, the trustee may avoid a transfer of property of the estate – (1) made after the commencement of the case; and (2)(A) that is authorized only under § 303(f) or § 542(c) of this title; or (B) that is not authorized under this title or by the court . . . (c) the trustee may not avoid under subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected."

STATEMENT OF THE CASE

On July 8, 1993, James and Clara McConville ("Debtors") contracted to purchase from Bay View Federal Bank ("Bay View") an eight-unit apartment building in Oakland, California (the "Property") for $122,000. The sale terms required escrow to close by August 7, 1993. Debtors initially deposited $10,000 with Bay View, which sum would be forfeited if they defaulted.

On July 14, 1993, Debtors filed a joint, voluntary Chapter 11 petition in bankruptcy.

In early August 1993, Debtors paid an additional $5,000 to Bay View in non-refundable funds to extend the close of escrow to August 13, 1993. Debtors initially anticipated that Cal-State Equities, a company owned by Robert Kamp, would finance the purchase of the Property. When Cal-State Equities decided not to fund the purchase, Debtors requested that such funding be provided by Lawton & Associates and David Margen ("Respondents"). Lawton & Associates was a licensed real estate agent, and it had presented the Property to the Debtors. Lawton shared office space with David Margen, and they both invested in distressed real property, as did Debtors. Although Respondents agreed to finance the purchase, they agreed to loan the money for only a thirty day period.

On August 13, 1993 – almost a month after Debtors filed their Chapter 11 case – the escrow on the Property closed. The deed from Bay View to Debtors was recorded in the Office of the Alameda County Recorder on August 13, 1993. Debtors paid, in cash, $25,460 of the $122,000 purchase price. To finance the balance of the purchase

price, Debtors, on August 12, 1993, executed and delivered to Respondents a $107,000 promissory note which was due and payable in thirty days (the "Note"). While the Note had a face amount of $107,000, Respondents only advanced $97,000.00, withholding $10,000 as a loan fee[2]. As security for the Note, Debtors executed and delivered a deed of trust against the Property in favor of Respondents for $107,000, which deed of trust was recorded with the County Recorder of Alameda County on August 13, 1993, following recordation of the deed.

On September 13, 1993, Debtors' Chapter 11 case was converted to a Chapter 7 bankruptcy, and Petitioner was appointed as the Chapter 7 trustee for the Debtors' bankruptcy estate. Respondents thereafter unsuccessfully moved for relief from the automatic stay to foreclose on the deed of trust. After the bankruptcy court denied that motion, Petitioner filed a complaint to avoid the lien created by the deed of trust, pursuant to Bankruptcy Code section 549(a). Respondents, in turn, asserted in their answer that the deed of trust was a "transfer of real property to a good faith purchaser" under Bankruptcy Code section 549(c), and thus was protected from Petitioner's attempt to avoid the deed of trust. Before the trial, Petitioner, over Respondents' objection, sold the

---

[2] The $10,000 loan free for the 30-day $97,000 loan amounted to an annual effective rate of 123.6% in addition to the interest rate on the note. Respondents extracted from debtors an unlawful signed waiver of a state-mandated disclosure statement with respect to the loan fee. They only dropped their claim for the portion of the note representing the loan fee after Petitioner, upon discovery of the waiver, demanded payment of the $10,000.

property for $137,000, free and clear of the lien of the deed of trust, pursuant to an order of the bankruptcy court which transferred the lien, if any, to the proceeds of the sale.

The bankruptcy court, after a trial on the merits, held for the Petitioner and avoided Respondents' lien on the sale proceeds. Judgement Avoiding Lien (App. *infra* F). It held, among other things, that (1) the post-petition transfer and recordation of Respondents' deed of trust was an unauthorized transfer of property of the bankruptcy estate, which violated Bankruptcy Code section 549(a); (2) the transfer of the deed of trust violated the Bankruptcy Code's automatic stay under section 362(a)(4); (3) the transfer of the deed of trust violated Bankruptcy Code section 364; and (4) Respondents did not qualify for the defense under section 549(c) available to good faith purchasers of real property. Findings of Fact and Conclusions of Law (App. *infra* E). The district court affirmed the bankruptcy court's order, holding that Respondents were not "purchasers" under Bankruptcy Code section 549(c). (App. *infra* D).

The Ninth Circuit thereafter issued three written opinions. The initial May 21, 1996 opinion and order affirmed the district court's judgment on the ground that Respondents' recordation of the deed of trust violated the automatic stay, rendering the deed of trust void as a matter of law. (App. *infra* C). The second opinion, which was issued on September 26, 1996 in response to Respondents' first petition for rehearing, amended the May 1996 opinion, but still affirmed the district court's judgment on the ground that the recordation of the deed of trust violated the Bankruptcy Code's automatic stay. (App.

infra B). In both instances, the Ninth Circuit held that Petitioner could not avoid the transfer of the deed of trust under section 549(a) on the ground that the transfer of a lien was not a "transfer" of property.

Respondents then filed another petition for rehearing. In response, the Ninth Circuit, after requesting and receiving letter briefs, withdrew its September, 1996 opinion and issued its third and final opinion and order. (App. *infra* A). There, the Ninth Circuit again held that the granting and recording of the deed of trust was not a "transfer" of property under section 549. (*Id.* pp. 6a-7a). Rather, the Ninth Circuit held that the unauthorized deed of trust violated section 364(c) of the Bankruptcy Code, which permits a debtor to obtain secured credit **only** after a noticed hearing and approval of the bankruptcy court. (*Id.* p. 7a) However the Ninth Circuit, *sua sponte*, then fashioned an equitable remedy holding that the transaction could be rescinded and, pursuant thereto, ordered that Respondents receive a $97,000 lien on the proceeds from the sale of the Property. (*Id.* pp. 8a-9a) At no time had Respondents ever asserted a right to rescission, either offensively or defensively. Petitioner's Petition for Rehearing and Suggestion for Hearing *En Banc* was denied by order dated May 27, 1997. (App. *infra* G). Pursuant to an order entered on June 11, 1997, the Ninth Circuit granted Petitioner's motion to stay the mandate pending the filing of Petitioner's petition for certiorari to this Court.

The jurisdiction of the bankruptcy court was based on 28 U.S.C. §§ 1334 and 157. Jurisdiction of the district court was based on 28 U.S.C. § 158(a). Jurisdiction of the Court of Appeals was based on 28 U.S.C. § 1291.

REASONS FOR GRANTING THE WRIT

I. THE NINTH CIRCUIT'S OPINION DIRECTLY CONFLICTS WITH THE DECISION OF THE SECOND CIRCUIT IN *IN RE PHOTO PROMOTION ASSOCIATES, INC.* AND THE FIFTH CIRCUIT IN *IN RE POINTER* AND CONTRADICTS THE EXPRESS LANGUAGE OF SECTION 101(54) OF THE BANKRUPTCY CODE

The Ninth Circuit's decision conflicts with the Second Circuit's decision in *In re Photo Promotion Associates, Inc.*, 881 F.2d 6 (2nd Cir. 1989) and with the Fifth Circuit's decision in *In re Pointer*, 952 F.2d 82 (5th Cir. 1992). In addition, the decision wholly undermines the definition of a "transfer" found in Bankruptcy Code section 101(54), which definition applies not only to section 549 but to most, if not all of the avoiding power sections of the Bankruptcy Code.

In *Photo Promotions*, the debtor granted a post-petition security interest of its receivables, and the assignee collected monies pursuant to it. Following conversion to Chapter 7, the trustee sued to recover the amounts collected. The Second Circuit affirmed the decisions of the bankruptcy court and district court, holding that the trustee had the right, under Bankruptcy Code section 549(a), to recover the payments made under the financing arrangement entered into in violation of Bankruptcy Code section 364(c). The Court further held that although the assignee had a potential section 503(b) administrative claim, that it first had to return the avoided transfer, and that its administrative claim would be junior to Chapter 7 creditors with superior claims.

In *In re Pointer*, the Fifth Circuit held that the imposition of an unauthorized, post-petition lien against real property was a "transfer" under section 549 of the Bankruptcy Code. The Fifth Circuit looked directly to the definition of the term "transfer" under the Bankruptcy Code, and noted that a "transfer" included every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest. . . . " 952 F.2d at 87. The Court held, however, that a creditor of the bankruptcy estate lacked standing to avoid the lien.

The First Circuit also disagrees in principle with the Ninth Circuit's decision. In both *In re Melon Produce, Inc.*, 976 F.2d 71 (1st Cir. 1992) and *Grella v. Salem Five Cent Savings Bank*, 427 F.3d 26 (1st Cir. 1994) the First Circuit held, in the context of defining a trustee's ability to avoid preferential transfers under Bankruptcy Code section 547, that the creation or perfection of a security interest in property of the bankruptcy estate (during the preference period) was a "transfer" of property as defined by the Bankruptcy Code. See *Melon*, 976 F.2d at 74 and *Grella* 42 F.3d 26 at 29, fn. 5.

The First, Second and Fifth Circuit's holdings are consistent with the Bankruptcy Code's definition of "transfer." The Official Comments to section 101(54) note that this definition was intended "to define transfer as broadly as possible to include any disposition of property or an interest in property." The Ninth Circuit's decision, holding that the granting of a post-filing lien is not a "transfer,"conflicts with this definition of transfer. The decision also conflicts with *U.S. v. Ron Pair Enterprises*,

489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) which held that the plain meaning of language of a statute should control its interpretation. 489 U.S. at 241, 242. Equally as important, by excluding from section 549, a post filing "transfer" of a security interest, when such a transaction constitutes a "transfer" for purposes of preferences (section 547) and fraudulent conveyances (section 548), the Ninth Circuit has violated this Court's "normal rule of statutory construction that" "identical words used in different parts of the same act are intended to have the same meaning." *Sullivan v. Stroop*, 496 U.S. 478, 484, 110 S.Ct. 2499, 2504, 110 L.Ed.2d 438 (1990) (quoting from *Sorenson v. Secretary of Treasury*, 475 U.S. 851, 860 106 S.Ct. 1600, 1606-1607, 89 L.Ed.2d 855 (1986)).

Therefore, the Ninth Circuit's decision in this matter not only conflicts with the First, Second and Fifth Circuits' definition of the term "transfer," but also calls into question trustee's ability to avoid transfers of liens under Bankruptcy Code sections 544 (strong arm clause), 547 (preferences) and 548 (fraudulent conveyances). The conflict is clear and the importance of this decision paramount.

II. IN ALLOWING A TRANSFEREE OF AN AVOIDABLE TRANSFER TO RETAIN THE BENEFIT OF HIS TRANSFER BY AFFORDING THE EQUITABLE REMEDY OF RESCISSION, NOTWITHSTANDING A CLEAR VIOLATION OF THE BANKRUPTCY CODE, THE NINTH CIRCUIT HAS GRANTED A REMEDY NOT PROVIDED FOR IN THE BANKRUPTCY CODE, OPENING A POTENTIAL FLOOD OF LITIGATION BY FUTURE DEFENDANTS IN BANKRUPTCY CASES

The Ninth Circuit definitively held that the transaction constituted an impermissible post-petition secured

loan under Bankruptcy Code section 364(c)(2). (App. *infra* A, p. 7a). The usual remedy in such an instance is that the transferee of the improperly secured debt loses the lien, and is relegated to the status of an administrative or unsecured creditor. See, *In re Photo Promotion Associates, Inc., supra,* 881 F.2d 6 (2nd Cir. 1989). In contrast, here the Ninth Circuit permitted Respondents to retain the wrongfully-obtained lien, thus receiving priority over administrative or unsecured creditors.

The Bankruptcy Code carefully and specifically sets forth defenses available to transferees of avoidable transfers. As such the Code provides definiteness and predictability to both parties and courts, delineating those transfers which are avoidable, and those which are not. Transferees of avoidable transfers often are unaware of the financial problems of their transferors. For example, many recipients of avoidable preferences under Bankruptcy Code § 547 fall into that category. Yet, unless they can provide a defense under one of the subsections of § 547(c), the code mandates that the transfer be avoided.

The Ninth Circuit decision in this matter changes all of that. By providing for a lien to the transferee under the doctrine of rescission, the Court opened up a completely new and uncharted defense to avoidance actions, not covered by the Code. The transferee who has no statutory defense, now has the right to raise equitable defenses and to seek to rescind the transaction[3]. For example, a supplier who was paid on account of merchandise sold, can

---

[3] Since this remedy was first raised *sua sponte* in the final opinion of the Ninth Circuit, Petitioner addressed this argument (and the argument in the next section) to the Ninth Circuit in his unsuccessful petition for rehearing.

meet a preference complaint with a counter claim for rescission,[4] asserting that he will repay the money when the trustee returns the merchandise. The decision of the Ninth Circuit, therefore, potentially opens the floodgate to litigation, and makes undefined, uncertain and unpredictable that which the Code renders definite, certain and predictable.

III. THE NINTH CIRCUIT EXCEEDED ITS AUTHORITY IN GRANTING RESCISSION WHEN IT HAD NOT BEEN SOUGHT, INSTEAD OF REMANDING THE MATTER TO THE TRIAL COURT FOR DETERMINATION

Respondents never sought rescission, either by affirmative defense or counterclaim. They unsuccessfully sought relief from the automatic stay to foreclose on their lien. They unsuccessfully opposed Petitioner's motion to sell the property free of the lien, with the lien, if any, attaching to the proceeds. In asserting those positions, Respondents sought to receive, to the exclusion of the estate, not just the $97,000 loaned to the debtors, but the

---

[4] In granting rescission, the Ninth Circuit purported to set forth the equities of the situation. In doing so, the Court incorrectly wrote that the trustee had "stipulated that the Lenders were in good faith." (App. *infra* 8a). The trustee did stipulate that the Lenders had no knowledge of the bankruptcy for purposes of Bankruptcy Code § 549(c). However, he did **not** stipulate that the lenders were "good faith purchasers" as that term is used in Bankruptcy Code § 549(c); in fact the good faith purchaser issue was the only issue tried by the Bankruptcy Court. The trial issue was over the right to assert the *statutory defense* of Bankruptcy Code section 549(c). There was no issue raised, at trial, of the right to assert the *equitable defense* of rescission.

$40,000 excess value above such loan. Respondents never requested rescission from the bankruptcy court, the district court, nor in two regular briefs, two petitions for rehearing and one letter brief, from the Ninth Circuit. (And, naturally, Petitioner never discussed that theory.) The factual basis for rescission was never tried to the bankruptcy court, and Petitioner never had an opportunity to introduce evidence to show why the equitable remedy of rescission should not have been granted.

The idea for rescission was created solely by the Ninth Circuit, as a way to reach a result that was not called for under the law in any of its three opinions.

It has long been the general rule that Courts of Appeal should not consider an issue not passed upon by lower courts. *Singleton v. Wulff*, 428 U.S. 106, 119-120, 96 S.Ct. 2868, 2877, 49 L.Ed. 2d 826 (1976); *Hormel v. Helvering*, 312 U.S. 552, 556, 61 S.Ct. 719, 721, 85 L.Ed. 1037 (1941). As stated in *Hormel*:

> "Ordinarily an appellate court does not give consideration to issues not raised below. For our procedural scheme contemplates that parties shall come to issue in the trial forum vested with authority to determine questions of fact. This is essential in order that parties may have the opportunity to offer all the evidence they believe relevant to the issues which the trial tribunal is alone competent to decide; it is equally essential in order that litigants may not be surprised on appeal by final decisions there of issues upon which they have had no opportunity to introduce evidence." 312 U.S. at 556.

The invoking of the remedy of rescission in the third and final opinion of the Ninth Circuit constituted an extreme departure from the accepted and usual course of judicial proceedings as articulated by this Court in *Singleton* and *Hormel*.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Dated: August 11, 1997

Respectfully submitted

KORNFIELD, PAUL & BUPP, P.C.

IRVING J. KORNFIELD
Counsel of Record
Attorney for Petitioner

APPENDIX A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE: JAMES DELBERT MCCONVILLE, *Debtor.*	No. 95-15122
	D.C. No. CV-94-03308-FMS
TEVIS T. THOMPSON, JR., Trustee, *Plaintiff-Appellee,* v. DAVID MARGEN; LAWTON ASSOCIATES, *Defendants-Appellants.*	ORDER AND OPINION

Appeal from the United States District Court
for the Northern District of California
Fern M. Smith, District Judge, Presiding

Argued and Submitted
April 9, 1996 – San Francisco, California

Filed May 21, 1996
Opinion Withdrawn March 26, 1997
Filed March 26, 1997

Before: James R. Browning and John T. Noonan,
Circuit Judges, and Robert R. Merhige, Jr.,* District Judge.

Opinion by Judge Noonan

*Honorable Robert R. Merhige, Jr., Senior U.S. District Judge for the Eastern District of Virginia, sitting by designation.

SUMMARY

Bankruptcy/Mortgages

After withdrawing its former opinion, the court of appeals modified a judgment of the district court and remanded the case. The court held that the remedy for bankrupt debtors incurring secured debt without court authorization is cancellation of the transaction.

James and Clara McConville (Debtors) filed for Chapter 11 bankruptcy. Appellant Lawton Associates, in conjunction with appellant David Margen (collectively, Lenders) agreed to make a bridge loan to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. The Debtors executed a note and deed of trust on the property in favor of the Lenders. The Debtors acquired the property, and the Lenders recorded the trust deed.

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding, and appellee Trustee was appointed. The Lenders sought relief from the automatic stay to foreclose the deed of trust, but the bankruptcy court denied that relief.

The Trustee filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer. The bankruptcy court held that the Lenders violated § 364; that although the Lenders were purchasers in good faith, recordation of the deed violated the automatic stay provisions; and that the transfer was not a transfer of real property to a good faith purchaser as provided in the exception created by § 549(c). The bankruptcy court

entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the property's sale.

On appeal, the district court affirmed, finding that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The Lenders appealed.

[1] Both the Trustee and the Lenders argued that the lien in favor of the Lenders was a transfer within the meaning of the bankruptcy code. Both the contentions are blocked by Ninth Circuit precedents holding that the creation of a lien does not transfer property for purposes of § 549(c).

[2] Section 364(c)(2) provides that if the trustee is unable to obtain unsecured credit, the court may authorize the incurring of debt secured by a lien on property of the estate that is not otherwise subject to a lien.

[3] Prior to the appointment of a trustee, the Debtors were fiduciaries of their own estate owing a duty of care and loyalty to the estate's creditors. By incurring secured debt without prior court authorization, the Debtors violated § 364(c)(2). An appropriate remedy for this disregard is cancellation by the court of the transaction. [4] It was equitable that the Lenders get back the amount they lent less what they had already been paid. They were entitled to a lien on the proceeds of the sale of the property.

COUNSEL

Jay-Allan Eisen, Eisen & Johnston Law Corporation. Sacramento, California, for the defendants-appellants.

Irving J. Kornfield, Kornfield, Paul & Bupp. Oakland, California, for the plaintiff-appellee.

ORDER

The opinion filed on May 21, 1996, and amended on September 26,1996 is hereby WITHDRAWN.

OPINION

NOONAN, Circuit Judge.

David Margen and Lawton Associates (the Lenders) appeal a judgment of the district court in favor of Tevis Thompson, Jr., (the Trustee), trustee in bankruptcy of James D. and Clara M. McConville (the Debtors). The judgment held voidable a deed of trust given by the Debtors to the Lenders after the Debtors had filed for bankruptcy. Applying § 364 of the Bankruptcy Code, we modify the judgment of the district court.

FACTS

The Debtors dealt in distressed real property. On July 8, 1993, the Debtors agreed to purchase from Bayview Federal Bank (Bayview) eight apartments at 725 Elmhurst, Oakland, California (the property) for $122,000. They paid $10,000 down to Bayview, nonrefundable. The closing was set no later than 30 days from July 8. The

Debtors counted on funding to be furnished by Robert Kamp. However, Kamp was unable to provide the funds by the closing date. The Debtors obtained an extension to August 13, 1993 and for this extension paid to the Bank an additional nonrefundable $5,000.

On July 14, 1993 the Debtors filed a Chapter 11 petition in bankruptcy. There is no evidence in the case that they disclosed this filing to Bayview, Kamp, or Lawton Associates, who had arranged with Kamp for him to make the loan on the property. When Kamp did not come up with the cash, the Lenders agreed to make a bridge loan to the Debtors to tide them over till Kamp came through. The Lenders believed that the property was worth more than $122,000. They were told by Kamp that the Debtors' credit was good and that he was looking for other opportunities to lend to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. They did not require a loan statement from the Debtors and had no representation from them as to their assets and liabilities.

On August 12 the Debtors executed a note and deed of trust on the property in favor of the Lenders in the principal amount of $107,000. The note was payable in 30 days. The interest was 12 per cent. The Lenders retained $10,000 of the loan as an additional fee. With the balance the Debtors acquired the property on August 13, 1993. On the same date the Lenders recorded the trust deed.

PROCEEDINGS

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding on September 13, 1993 and the

Trustee was appointed. The Lenders sought relief from the automatic stay to foreclose the deed of trust. The bankruptcy court denied the relief. The Trustee then filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer, voidable under Bankruptcy Code § 549(a). After a hearing, the bankruptcy court held the Debtors had acted in violation of § 364; that, although the Lenders were purchasers in good faith, recordation of the deed of trust violated the automatic stay of Bankruptcy Code § 362(a)(4); and that the transfer was not a transfer of real property to a good faith purchaser as provided in the exception created by Bankruptcy Code § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the sale of the property.

The Lenders appealed to the district court which held that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The judgment of the bankruptcy court was affirmed.

The Lenders appeal.

ANALYSIS

[1] This case was decided by the district court on the basis of § 549, and on the initial appeal both parties argued to this court in terms of § 549. Both parties vigorously argued that the lien in favor of the Lenders was a transfer within the meaning of the bankruptcy code. The Trustee argued that he might avoid it under § 549(a), while the Lenders argued that it qualified for the exception under § 549(c). Whatever the abstract merit of these

contentions, we find them both blocked by our precedents, *In re Schwartz*, 954 F.2d 569, 574 (9th Cir.1992), and *In re Shamblin*, 890 F.2d 123, 127 (9th Cir.1989), which simply hold that the creation of a lien does not transfer property for purposes of § 549.

[2] We asked for further briefing. The parties in effect concede that only an en banc court could change the rulings made in *Schwartz* and *Shamblin*. We are not disposed to ask for an en banc court if there is a simple way of resolving this case. We now hold that the Debtors' obtaining secured credit from the Lenders violated § 364(c)(2).

Section 364(c) and (c)(2) provide:

> (c) If the trustee is unable to obtain unsecured credit allowable under 503(b)(1) of this title as an administrative expense, the court, after notice and a hearing, may authorize the obtaining and credit or the incurring of debt –
>
> . . .
>
> (2) secured by a lien on property of the estate that is not otherwise subject to a lien. . . .

§§ 364(c) and (c)(2).

[3] Section 364 is applicable to the Debtors. Prior to the appointment of a trustee, the Debtors were fiduciaries of their own estate owing a duty of care and loyalty to the estate's creditors. *In re March*, 995 F.2d 32, 34 (4th Cir.1993). In such cases, § 364 applies to them. *See In re Century Brass Products*, 22 F.3d 37, 39-40 (2d Cir.1994); 2 *Collier on Bankruptcy*, ¶ 364.02, at 364-6 (1996). By incurring secured debt without prior court authorization, the Debtors violated § 364(c)(2). *See Collier's On Bankruptcy*,

¶ 364.04, at 364-11. An appropriate remedy for this disregard is cancellation by the court of the transaction. It is disruptive of bankruptcy for an estate to obtain fresh credit without regard to the court now supervising the estate. It is within the power of that court to rescind the contract unlawfully made.

The exercise of this corrective power, however, should not occur without regard to the equities of the situation, for, within the limits set by the Code, a bankruptcy court must do equity. *Bank of Marin v. England*, 385 U.S. 99, 103 (1966). The equities here are these: On the one hand, as the Lenders have not ceased to remind us, their loan enabled the Debtors to carry out their contract and so obtain the property for the estate. Moreover, the Trustee stipulated that the Lenders were in good faith, so that the question of their knowledge of the Debtors' actual bankruptcy was removed from the case. On the other hand, the Lenders had to know that the Debtors' position was precarious. The Debtors' inability to obtain the loan they'd counted on, the absence of any effort to get bank financing, and the total amount paid for the loan signalled their situation. In addition, the Lenders' failure to ask for any representation of the Debtors' financial condition amounted to pretty much wilful blindness. The Lenders' lack of knowledge of the Debtors' bankruptcy was not unavoidable.

[4] In these circumstances, we think it equitable that the Lenders get back the amount they lent less what they have already been paid; they should get no benefit from their loan. They are therefore entitled to a lien on $97,000 of the proceeds of the sale of the property.

We remand to the district court with direction to modify the decree of the bankruptcy court so that the Lenders have a lien on $97,000 of the estate.

REMANDED.

APPENDIX B

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: James Delbert McConville, *Debtor.*	No. 95-15122
Tevis T. Thompson, Jr., Trustee, *Plaintiff-Appellee,* v. David Margen; Lawton Associates, *Defendants-Appellants.*	D.C. No. CV-94-03308-FMS ORDER AND AMENDED OPINION

Appeal from the United States District Court
for the Northern District of California
Fern M. Smith, District Judge, Presiding

Argued and Submitted
April 9, 1996 – San Francisco, California

Filed May 21, 1996
Amended September 26, 1996

Before: James R. Browning and John T. Noonan, Jr., Circuit Judges, and Robert R. Merhige,* District Judge.

Opinion By Judge Noonan

---

* Honorable Robert R. Merhige, Jr., Senior U.S. District Judge for the Eastern District of Virginia, sitting by designation.

SUMMARY

Bankruptcy/Automatic Stay/Real Estate

The court of appeals affirmed a district court judgment. The court held that an exception to the automatic stay that applies to transfers of real property to a good faith purchaser has no application when, after filing for bankruptcy, debtors execute a deed of trust on property in favor of lenders.

James and Clara McConville (the Debtors) filed a Chapter 11 bankruptcy petition. Appellant Lawton Associates, in conjunction with appellant David Margen (collectively, the Lenders), agreed to make a bridge loan to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. The Debtors executed a note and deed of trust on property in favor of the Lenders. The Debtors acquired the property, and the Lenders recorded the trust deed.

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding, and appellee Tevis Thompson, Jr., was appointed as trustee. The Lenders sought relief from the automatic stay to foreclose the deed of trust, but the bankruptcy court denied that relief.

The Trustee filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer. The bankruptcy court held that the Lenders were purchasers in good faith, but that both the execution of the deed of trust and its recordation violated the automatic stay of Bankruptcy Code § 362(a)(4) and that the transfer was not a transfer of real property to a good faith

purchaser as provided in an exception created by § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the property's sale.

On appeal, the district court affirmed, holding that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The Lenders appealed.

[1] No exception to the automatic stay is provided for the creating, perfecting, or enforcing of a lien obtained by a simple lender to the estate.

[2] Ninth Circuit precedents as to real property refuted the Lenders' argument that the deed of trust executed in their favor fell within the exception of § 549(c). [3] All that execution of a deed of trust accomplishes in California is creation of a lien in favor of the creditor. The Ninth Circuit previously held that the mere creation of a lien does "not actually transfer the property itself for purposes of section 549." Under precedents, § 549(c) had no application, and the automatic stay voided the attempted perfection of the lien.

[4] In addition, there was no real property on which a lien under § 549(c) could operate. No transfer was made, and the Lenders' attempted perfection of a lien was void.

COUNSEL

Jay-Allan Eisen, Eisen & Johnston, Sacramento, California, for the defendants-appellants.

Irving J. Kornfield, Kornfield, Paul & Bupp, Oakland, California, for the plaintiff-appellee.

ORDER

The opinion filed on May 21, 1996 is amended as follows:

Slip opinion p. 6066:

Revise the last sentence to add "as to real property" after "precedents".

Slip opinion p. 6067:

Strike all of ¶ 3 and renumber subsequent paragraphs.

New ¶ 3, last line, add the word "perfection of the" before "lien".

Slip opinion p. 6068, lines 1 and 2:

Place the word "real" before "property".

Slip opinion p. 6068, line 4:

Place "Lenders' " before "attempted". Substitute "perfection" for "creation".

OPINION

NOONAN, Circuit Judge:

David Margen and Lawton Associates (the Lenders) appeal a judgment of the district court in favor of Tevis Thompson, Jr., (the Trustee), trustee in bankruptcy of

James D. and Clara M. McConville (the Debtors). The judgment held void a deed of trust given by the Debtors to the Lenders after the Debtors had filed for bankruptcy. Applying § 362(a)(4) of the Bankruptcy Code, we affirm the judgment of the district court.

FACTS

The Debtors dealt in distressed real property. On July 8, 1993, the Debtors agreed to purchase from Bayview Federal Bank (Bayview) eight apartments at 725 Elmhurst, Oakland, California (the property) for $122,000. They paid $10,000 down to Bayview, nonrefundable. The closing was set no later than 30 days from July 8. The Debtors counted on funding to be furnished by Robert Kamp. However, Kamp was unable to provide the funds by the closing date. The Debtors obtained an extension to August 13, 1993 and for this extension paid to the Bank an additional nonrefundable $5,000.

On July 14, 1993 the Debtors filed a Chapter 11 petition in bankruptcy. There is no evidence in the case that they disclosed this filing to Bayview, Kamp, or Lawton Associates, who had arranged with Kamp for him to make the loan on the property. When Kamp did not come up with the cash, Lawton Associates in conjunction with David Margen (collectively, the Lenders) agreed to make a bridge loan to the Debtors to tide them over till Kamp came through. The Lenders believed that the property was worth more than $122,000. They were told by Kamp that the Debtors' credit was good and that he was looking for other opportunities to lend to the Debtors. The Lenders had no information that the Debtors had already

filed for bankruptcy. They did not require a loan statement from the Debtors and had no representation from them as to their assets and liabilities.

On August 12 the Debtors executed a note and deed of trust on the property in favor of the Lenders in the principal amount of $107,000. The note was payable in 30 days. The Lenders retained $10,000 of the loan as a fee. With the balance the Debtors acquired the property on August 13, 1993. On the same date the Lenders recorded the trust deed.

PROCEEDINGS

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding on September 13, 1993 and the Trustee was appointed. The Lenders sought relief from the automatic stay to foreclose the deed of trust. The bankruptcy court denied the relief. The Trustee then filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer, voidable under Bankruptcy Code § 549(a). After hearing, the bankruptcy court held that the Lenders were purchasers in good faith, but that both the execution of the deed of trust and its recordation violated the automatic stay of Bankruptcy Code § 362(a)(4) and that the transfer was not a transfer of real property to a good faith purchaser as provided in the exception created by Bankruptcy Code § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the sale of the property.

The Lenders appealed to the district court which held that a lender who acquired a lien on real property was

not a "purchaser" within the meaning of § 549(c). The judgment of the bankruptcy court was affirmed.

The Lenders appeal.

ANALYSIS

[1] The transfer of any interest after the filing of the bankruptcy petition is in literal violation of 11 U.S.C. § 362(a)(4), according to which a petition "operates as a stay, applicable to all entities, of . . . any act to create, perfect, or enforce any lien against property of the estate." Section 362(b)(1) through (18) creates explicit exceptions to the automatic stay. No exception is provided for the creating, perfecting or enforcing of a lien obtained by a simple lender to the estate.

This prohibition needs to be reconciled with the exception created by § 549(c), according to which:

> The Trustee may not avoid under Subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy

> or notice of the petition was so filed before such transfer was so perfected.

[2] The Lenders argue that a transfer of property occurred because a transfer is "every mode, direct or indirect, absolute or conditional . . . of disposing of or parting with property or with an interest in property, including retention of title as a security interest." 11 U.S.C. § 101(54); that they are purchasers, because a purchaser "means transferee of a voluntary transfer," *id.* § 101(43); and that the bankruptcy court found as a matter of law that they took the transfer in good faith, so they must be good faith purchasers. Consequently, they contend, the deed of trust executed in their favor falls within the exception of section 549(c) and trumps the prohibition of section 362(a)(4). Their argument is not without force but is refuted by our precedents as to real property.

[3] It is long-established California law that deeds of trust are "practically and substantially only mortgages with a power of sale." *Bank of Italy v. Bentley*, 217 Cal. 644, 657, 20 P.2d 940, *cert. denied*, 54 S.Ct. 74 (1933). All that execution of a deed of trust accomplishes in California is the creation of a lien in favor of the creditor. *St. Angelo v. Victoria Farms, Inc.*, 38 F.3d 1525, 1534 (9th Cir. 1994), *modified* 46 F.3d 969 (1995), *citing Monterey S.P. Partnership v. W.L. Bangham, Inc.*, 49 Cal.3d 454, 460, 211 Cal.Rptr. 587, 777 P.2d 623 (1989). The mere creation of a lien, we held in *In re Schwartz*, 954 F.2d at 574, does "not actually transfer the property itself for purposes of section 549." *Accord, In re Shamblin*, 890 F.2d 123, 127 (9th Cir. 1989). Under these precedents, section 549(c) has no application

and the automatic stay voids the attempted perfection of the lien.

[4] The Lenders have a fall-back position, arguing that under the second sentence of section 549(c) they have at least "a lien on the property transferred to the extent of any present value given." Their fall-back argument has an equitable appeal but it encounters the same difficulty as their principal contention: the statute refers to "the property transferred," but under *In re Schwartz* and *In re Shamblin* no real property was transferred. There is, therefore, no real property on which the lien of the second sentence of section 549(c) may operate. No transfer was made. The Lenders' attempted perfection of a lien was void.

AFFIRMED.

APPENDIX C

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE: JAMES DELBERT MCCONVILLE, *Debtor.*	
TEVIS T. THOMPSON, JR., Trustee, *Plaintiff-Appellee,* v. DAVID MARGEN; LAWTON ASSOCIATES, *Defendants-Appellants.*	No. 95-15122 D.C. No. CV-94-03308-FMS OPINION

Appeal from the United States District Court
for the Northern District of California
Fern M. Smith, District Judge, Presiding

Argued and Submitted
April 9, 1996 – San Francisco, California

Filed May 21, 1996

Before: James R. Browning and John T. Noonan, Jr., Circuit Judges, and Robert R. Merhige,* District Judge.

Opinion By Judge Noonan

---

* Honorable Robert R. Merhige, Jr., Senior U.S. District Judge for the Eastern District of Virginia, sitting by designation.

SUMMARY

Bankruptcy/Automatic Stay/Real Estate

The court of appeals affirmed a district court judgment. The court held that an exception to the automatic stay that applies to transfers of real property to a good faith purchaser has no application when, after filing for bankruptcy, debtors execute a deed of trust on property in favor of lenders.

James and Clara McConville (the Debtors) filed a Chapter 11 bankruptcy petition. Appellant Lawton Associates, in conjunction with appellant David Margen (collectively, the Lenders), agreed to make a bridge loan to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. The Debtors executed a note and deed of trust on property in favor of the Lenders. The Debtors acquired the property, and the Lenders recorded the trust deed.

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding, and appellee Tevis Thompson, Jr., was appointed as trustee. The Lenders sought relief from the automatic stay to foreclose the deed of trust, but the bankruptcy court denied that relief.

The Trustee filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer. The bankruptcy court held that the Lenders were purchasers in good faith, but that both the execution of the deed of trust and its recordation violated the automatic stay of Bankruptcy Code § 362(a)(4) and that the transfer was not a transfer of real property to a good faith

purchaser as provided in an exception created by § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the property's sale.

On appeal, the district court affirmed, holding that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The Lenders appealed.

[1] No exception to the automatic stay is provided for the creating, perfecting, or enforcing of a lien obtained by a simple lender to the estate.

[2] Ninth Circuit precedents refuted the Lenders' argument that the deed of trust executed in their favor fell within the exception of § 549(c). [3] Under a prior Ninth Circuit case, the Lenders' execution of the deed of trust was not "a transfer of the property." [4] All that execution of a deed of trust accomplishes in California is creation of a lien in favor of the creditor. The Ninth Circuit previously held that the mere creation of a lien does "not actually transfer the property itself for purposes of section 549." Under precedents, § 549(c) had no application, and the automatic stay voided the attempted lien.

[5] In addition, there was no property on which a lien under § 549(c) could operate. No transfer was made, and the attempted creation of a lien was void.

COUNSEL

Jay Allan Eisen, Eisen & Johnston, Sacramento, California, for the defendants-appellants.

Irving J. Kornfield, Kornfield, Paul & Bupp, Oakland, California, for the plaintiff-appellee.

OPINION

NOONAN, Circuit Judge:

David Margen and Lawton Associates (the Lenders) appeal a judgment of the district court in favor of Tevis Thompson, Jr., (the Trustee), trustee in bankruptcy of James D. and Clara M. McConville (the Debtors). The judgment held void a deed of trust given by the Debtors to the Lenders after the Debtors had filed for bankruptcy. Applying § 362(a)(4) of the Bankruptcy Code, we affirm the judgment of the district court.

FACTS

The Debtors dealt in distressed real property. On July 8, 1993, the Debtors agreed to purchase from Bayview Federal Bank (Bayview) eight apartments at 725 Elmhurst, Oakland, California (the property) for $122,000. They paid $10,000 down to Bayview, nonrefundable. The closing was set no later than 30 days from July 8. The Debtors counted on funding to be furnished by Robert Kamp. However, Kamp was unable to provide the funds by the closing date. The Debtors obtained an extension to August 13, 1993 and for this extension paid to the Bank an additional nonrefundable $5,000.

On July 14, 1993 the Debtors filed a Chapter 11 petition in bankruptcy. There is no evidence in the case that they disclosed this filing to Bayview, Kamp, or Lawton Associates, who had arranged with Kamp for him to

make the loan on the property. When Kamp did not come up with the cash, Lawton Associates in conjunction with David Margen (collectively, the Lenders) agreed to make a bridge loan to the Debtors to tide them over till Kamp came through. The Lenders believed that the property was worth more than $122,000. They were told by Kamp that the Debtors' credit was good and that he was looking for other opportunities to lend to the Debtors. The Lenders had no information that the Debtors had already filed for bankruptcy. They did not require a loan statement from the Debtors and had no representation from them as to their assets and liabilities.

On August 12 the Debtors executed a note and deed of trust on the property in favor of the Lenders in the principal amount of $107,000. The note was payable in 30 days. The Lenders retained $10,000 of the loan as a fee. With the balance the Debtors acquired the property on August 13, 1993. On the same date the Lenders recorded the trust deed.

PROCEEDINGS

The Debtors' bankruptcy case was converted to a Chapter 7 proceeding on September 13, 1993 and the Trustee was appointed. The Lenders sought relief from the automatic stay to foreclose the deed of trust. The bankruptcy court denied the relief. The Trustee then filed a complaint to void the lien created by the deed of trust as an unauthorized, post-petition transfer, voidable under Bankruptcy Code § 549(a). After hearing, the bankruptcy court held that the Lenders were purchasers in good faith, but that both the execution of the deed of trust and

its recordation violated the automatic stay of Bankruptcy Code § 362(a)(4) and that the transfer was not a transfer of real property to a good faith purchaser as provided in the exception created by Bankruptcy Code § 549(c). The bankruptcy court entered judgment for the Trustee, declaring that the Lenders had no lien against the proceeds of the sale of the property.

The Lenders appealed to the district court which held that a lender who acquired a lien on real property was not a "purchaser" within the meaning of § 549(c). The judgment of the bankruptcy court was affirmed.

The Lenders appeal.

ANALYSIS

[1] The transfer of any interest after the filing of the bankruptcy petition is in literal violation of 11 U.S.C. § 362(a)(4), according to which a petition "operates as a stay, applicable to all entities, of . . . any act to create, perfect, or enforce any lien against property of the estate." Section 362(b)(1) through (18) creates explicit exceptions to the automatic stay. No exception is provided for the creating, perfecting or enforcing of a lien obtained by a simple lender to the estate.

This prohibition needs to be reconciled with the exception created by § 549(c), according to which:

> The Trustee may not avoid under Subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real

> property may be recorded to perfect such transfer, before such transfer is so perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.

[2] The Lenders argue that a transfer of property occurred because a transfer is "every mode, direct or indirect, absolute or conditional . . . of disposing of or parting with property or with an interest in property, including retention of title as a security interest." 11 U.S.C. § 101(54); that they are purchasers, because a purchaser "means transferee of a voluntary transfer," *id.* § 101(43); and that the bankruptcy court found as a matter of law that they took the transfer in good faith, so they must be good faith purchasers. Consequently, they contend, the deed of trust executed in their favor falls within the exception of section 549(c) and trumps the prohibition of section 362(a)(4). Their argument is not without force but is refuted by our precedents.

[3] In *In re Schwartz*, 954 F.2d 569, 573 (9th Cir. 1992) we recognized a conflict that "appears troublesome" between § 549(c) and § 362. It was unnecessary for us to resolve the conflict in *In re Schwartz*, which decided only that a tax assessment in violation of § 362 was void. *Id.* 572. Nonetheless in dicta we ventured to say that the

conflict was only apparent because "Section 362's automatic stay does not apply to sales or transfers of property initiated by the debtor." *Id.* at 574. We cited no authority for this explanation. If it were true, it might decide our case in favor of the Lenders whose deed of trust could be argued to be a transfer of property initiated by the Debtors. We find it, however, not necessary to pass upon the truth of the explanation because under *In re Schwartz* itself, the Lenders' execution of the deed of trust was not "a transfer of the property."

[4] It is long-established California law that deeds of trust are "practically and substantially only mortgages with a power of sale." *Bank of Italy v. Bentley,* 217 Cal. 644, 657, 20 P.2d 940, *cert. denied* 54 S.Ct. 74 (1933). All that execution of a deed of trust accomplishes in California is the creation of a lien in favor of the creditor. *St. Angelo v. Victoria Farms, Inc.,* 38 F.3d 1525, 1534 (9th Cir. 1994), *modified* 46 F.3d 969 (1995), *citing Monterey S.P. Partnership v. W.L. Bangham, Inc.,* 49 Cal.3d 454, 460, 211 Cal.Rptr. 587, 777 P.2d 623 (1989). The mere creation of a lien, we held in *In re Schwartz,* 954 F.2d at 574, does "not actually transfer the property itself for purposes of section 549." Accord, *In re Shamblin,* 890 F.2d 123, 127 (9th Cir. 1989). Under these precedents, section 549(c) has no application and the automatic stay voids the attempted lien.

[5] The Lenders have a fall-back position, arguing that under the second sentence of section 549(c) they have at least "a lien on the property transferred to the extent of any present value given." Their fall-back argument has an equitable appeal but it encounters the same difficulty as their principal contention: the statute refers to "the property transferred," but under *In re Schwartz*

and *In re Shamblin* no property was transferred. There is, therefore, no property on which the lien of the second sentence of section 549(c) may operate. No transfer was made. The attempted creation of a lien was void.

AFFIRMED.

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re JAMES DELBERT McCONVILLE, CLARA MAE McCONVILLE, dba McCONVILLE ENTERPRISES, Debtor.	No. C 94-3308-FMS ORDER AFFIRMING THE BANKRUPTCY COURT'S JUDGMENT
TEVIS THOMPSON, JR., Plaintiff(s), vs. DAVID MARGEN AND LAWTON ASSOCIATES, Defendant(s).	(Filed Dec. 13, 1994)

ISSUES

This appeal requires the Court to decide whether a lender, who records a lien on real property as security for its loan, is a "purchaser" for value of "real property"[1] within the meaning of bankruptcy code § 549(c). For the reasons stated below, the Court AFFIRMS the bankruptcy court's judgment.

---

[1] Because the Court affirms the bankruptcy court's judgment on other grounds, the Court declines to address this issue.

BACKGROUND

On July 8, 1993, debtor James Delbert McConville ("McConville") contracted with Bay View Federal Bank to purchase an apartment building in Oakland, California.

On July 14, 1993, McConville and his wife, Clara Mae McConville (collectively, "debtors") filed a chapter 11 petition in bankruptcy.

In order to finance the purchase of the apartment, appellants David Margen ("Margen") and Lawton Associates ("Lawton") (collectively, "appellants"), agreed to loan McConville money after McConville was denied a loan by another lender. A promissory note payable to appellants was executed on August 12, 1993. As security for the note, debtors executed and delivered a deed of trust against the apartment in favor of appellants on August 12, 1993. The deed of trust was recorded on August 13, 1993 immediately following recordation of the deed to debtors.

On September 13, 1993, debtors' bankruptcy case was converted to a Chapter 7 bankruptcy. Appellants sought relief from the automatic stay to foreclose on the apartment, but relief was denied. Bankruptcy estate trustee Tevis Thompson, Jr. ("Thompson") filed a complaint to avoid the lien created by appellants' deed of trust, asserting that such deed was an unauthorized, post-petition transfer under Bankruptcy Code § 549(a). Appellants asserted that the transfer to them was a transfer of real property to a good faith purchaser for value, thereby excluding it from Thompson's avoidance powers.

The Bankruptcy Court held that 1) the recordation of the appellants' deed of trust, post-petition, and without authorization under the Bankruptcy Code or from the court, was avoidable by Thompson pursuant to Bankruptcy Code § 549(a); and 2) that the appellants did not qualify for the defense provided in bankruptcy code § 549(c) as good faith purchasers for value of real property. The Bankruptcy Court therefore entered judgment in favor of Thompson to avoid the appellants' lien.

DISCUSSION

I. Standard of Review

On appeal, the factual findings of a bankruptcy court are reviewed under a clearly erroneous standard, and its legal conclusions are reviewed *de novo*. *In re Pizza of Haw., Inc.*, 761 F.2d 1374, 1377 (9th Cir. 1985).

II. Thompson May Avoid Appellants' Lien Because Appellants Are Not Good Faith "Purchasers" Within The Meaning Of Section 549(c)

Bankruptcy Code § 549(a) provides in pertinent part that a trustee may avoid a transfer of property of the estate made after the commencement of the case, except as provided in § 549(b)[2] or § 549(c). 11 U.S.C. § 549(a). Section 549(c) provides in pertinent part that the trustee may not avoid under § 549(a) a transfer of *real property* to

---

[2] The Court need not address the applicability of section 549(b) because lenders have not asserted this defense.

a *good faith purchaser* without knowledge of the commencement of the case for present fair equivalent value. 11 U.S.C. § 549(c) (emphasis added). Appellants assert that as lenders who loaned debtors money after debtors' bankruptcy petition, appellants are good faith purchasers and that the transfer of the deed was a transfer of a real property interest.

A "purchaser" is defined in Bankruptcy Code § 101(43) as including a transferee of a voluntary transfer. Appellants assert that although they are technically lenders, § 21g of the 1939 Bankruptcy Act (the predecessor of § 549(c)) protected lienors in addition to purchasers. Appellants thus reason that they should be protected as "purchasers" under §§ 101(43) and 549(c). Appellants also refer to a secondary source which includes creditors in the "purchaser" definition.[3] Finally, appellants assert that it would be unfair to uphold a decision which effectively leaves appellants with a $97,000 loss.

Thompson responds that appellants are not included within the definition of "purchasers" because "purchasers" has been defined narrowly and lenders do not fit within that definition. Thompson also relies upon judgment-sale cases in which courts have historically treated foreclosing mortgagees less favorably than purchasers. The courts have reasoned in the majority of those cases

---

[3] 3 *See* Norton, Bankruptcy Law and Practice 2d 59-7 (1994). Norton fails to cite any binding or persuasive authority for his conclusion and the Court declines to follow Norton's interpretation for the reasons noted herein.

that the mortgagees either had knowledge of the bankruptcy (thus failing the good faith requirement) or did not pay fair equivalent value for the property. Courts have also indicated that the intent behind § 549(c) was not to protect mortgagees at a foreclosure sale. *In re Penfil*, 40 B.R. 474, 478 (Bankr. E.D. Mich. 1984).

After a reasonable search, the Court has found no authority and the parties have not cited any, which determines whether a lender who records a lien on real property, as security for its loan, is a "purchaser" within the meaning of § 549(c). The Court therefore turns to the purpose of the statute.

The purpose of § 549(c) is to protect the innocent purchaser from unscrupulous behavior on the part of the debtor. *In re Purnell*, 92 B.R. 625, 629 (Bankr. E.D. Pa. 1988). More specifically, § 549(c) is to protect against a fraudulent debtor selling real property to an innocent purchaser who has no knowledge, or reasonable means of knowledge, of the pendency of the bankruptcy proceedings. *Id.* (citations omitted). Historically, the section has been invoked when the real estate has been sold in a county outside of where the bankruptcy proceeding is pending. *See* 2 Collier on Bankruptcy, ¶ 21.30 (14th ed. 1976); *In re Allen*, 816 F.2d 325 (7th Cir. 1987).

The Court is swayed by those cases in which foreclosing mortgagees have been treated less favorably than purchasers. *See, e.g., Purnell*, 92 B.R. at 630. Had the present case proceeded to foreclosure, appellants would have received property valued in excess of $120,000 for $97,000, thereby calling into question whether appellants

purchased the land for present equivalent value. Furthermore, the apartment was within the same county in which the bankruptcy was filed (Alameda county); appellants therefore had a reasonable means of obtaining knowledge of debtors bankruptcy.[4]

The Court also finds support for its decision on public policy grounds. If appellants, even in good faith, were given the same favorable treatment as good faith purchasers, lenders in positions similar to appellants would have an incentive not to investigate the financial standing of its potential borrowers because lenders would effectively "leapfrog" over other bankruptcy estate creditors if the loan was made post-petition. Moreover, the collusive possibilities for such an arrangement are high, despite the good faith requirement. Accordingly, the Court holds that appellants are not good faith purchasers under § 549(c).

---

[4] While the Court understands appellants' plight, appellants failed to duly investigate debtors' financial standing. Appellants did not require debtors to complete a loan application or submit a financial statement and, instead, relied on past dealings with McConville and a favorable report of debtors' credit history.

CONCLUSION

For the reasons stated above, the bankruptcy court's judgment granting Thompson authority to avoid appellants' lien is AFFIRMED and the hearing scheduled for December 16, 1994 is VACATED.

SO ORDERED.

DATED: December 13, 1994

/s/ Fern M. Smith
FERN M. SMITH
United States District Judge

APPENDIX E

IRVING J. KORNFIELD, ESQ. (Bar No. 033880)
HOWARD RUTTEN, ESQ. (Bar No. 164820)
KORNFIELD, PAUL & BUPP, P.C.
1999 Harrison Street, Suite 800
Oakland, California 94612
Telephone: (510) 763-1000

Attorneys for Tevis Thompson, Jr., Trustee

UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re **JAMES DELBERT McCONVILLE, CLARA MAE McCONVILLE, dba McCONVILLE ENTERPRISES,** **Debtors.**	**Case No. 93-44971 N** **Chapter 7**
TEVIS THOMPSON, JR., Trustee in Bankruptcy, **Plaintiff,** **vs.** **DAVID MARGEN and LAWTON ASSOCIATES, a California partnership,** **Defendants.**	**Adversary Proceeding No. 93-4541 N** **FINDINGS OF FACT AND CONCLUSIONS OF LAW** **Date: April 4, 1994** **Time: 9:30 a.m.** **Room: 220** **(Filed Apr. 22, 1994)**

This case came on for trial on April 4, 1994, the court having heard the evidence and considered the stipulations and argument of the parties, states the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. James D. McConville and Clara M. McConville filed a Chapter 11 petition in bankruptcy on July 14, 1993. Said case was converted to a Chapter 7 on September 13, 1993. Plaintiff is the Chapter 7 trustee.

2. On July 2, 1993, the debtors made an offer to Bayview Federal Bank to purchase real property located at 725 South Elmhurst, Oakland, California (the "Property"). Bayview Federal Bank made a counter-offer to said offer on July 8, 1993. Such counter-offer was accepted by the debtor on July 8, 1993.

3. On July 8, 1993, the debtors entered into a contract with Bayview Federal Bank for the purchase of the Property.

4. The debtors subsequently acquired the Property pursuant to such contract.

5. The debtors paid $15,000 directly to Bayview and deposited into escrow an additional $10,460.18, thus paying a total of $25,460.18 toward the purchase of the Property.

6. Bayview executed a grant deed of the Property to the debtors on August 9, 1993, which was recorded on August 13, 1993 in the official records of the Alameda County Recorder's office as instrument no. 93-290112.

7. On or about August 12, 1993, the debtors executed a promissory note in favor of the defendants in the amount of $107,000 to finance the purchase of the Property. Said note was a 30-day note with interest at the annual rate of twelve percent (12%). Defendants charged the debtors a $10,000 loan fee for the making of the loan, which amount was included in the $107,000.

8. On or about August 12, 1993, the debtors executed a deed of trust on the Property in favor of the defendants to secure the note. Said deed of trust was recorded in the official records of the Alameda County Recorder's office on August 13, 1993, as instrument no. 93-290113 following recordation of the deed.

9. Defendants advanced only $97,000 for the benefit of debtors and have agreed, by stipulation, that such amount, plus interest, is the amount of their claim.

10. Defendant Lawton Associates is a California Real Estate Broker and represented debtors in the acquisition of the Property.

11. Defendant Margen shares offices with defendant Lawton and the defendants jointly invest in distressed real property. Defendants were not in the business of making loans.

12. Debtors were engaged in the business of owning and operating distressed real property.

13. The defendants, in making the loan to the debtors, did not require the debtors to complete a loan application or submit a financial statement. However, defendants did make inquiry of debtors' credit history

and received a favorable report on which they reasonably relied.

14. While the terms of the loan were not favorable to the debtors, the evidence indicates that debtors knew what they were doing, and, in the totality of the circumstances, the loan was an arm's length transaction between the defendants and the debtors.

15. No authority was obtained from the bankruptcy court during the Chapter 11 case for the debtors to obtain secured credit.

16. Neither defendant had actual knowledge of the bankruptcy when the deed of trust was taken.

17. This court previously approved the sale of the Property by the trustee with defendants' lien, if any, attaching to the proceeds thereof.

18. To the extent any such findings of fact are determined to be conclusions of law, it shall be deemed to have been set forth herein as a conclusion of law.

CONCLUSIONS OF LAW

1. The real property located at 725 South Elmhurst, Oakland, California, was property of the debtors' bankruptcy estate on August 13, 1993.

2. The debtors' transferring of a deed of trust on said property to the defendants constituted a transfer of property of the estate after the commencement of the case to the defendants. Said transfer was made without approval of the court or the Bankruptcy Code.

3. The transfer of the deed of trust on the Property was in violation of §364 of the Bankruptcy Code.

4. The recordation of the deed of trust on the Property was in violation of §362(a)(4) of the Bankruptcy Code.

5. The transfer of the deed of trust on the property to defendants was not "a transfer of real property to a good faith purchaser" as provided under §549(c) of the Bankruptcy Code.

6. The transfer is avoidable by the trustee pursuant to Bankruptcy Code §549(a).

7. The defendants did take the transfer in good faith within the meaning of Bankruptcy Code §549(c).

8. The defendants did not make any improvements to the property after such transfer within the meaning of Bankruptcy Code §550(d).

9. Plaintiff is entitled to have judgment entered avoiding the lien of the deed of trust and declaring that defendants have no lien against the proceeds of the sale of the Property.

10. To the extent that any of the court's conclusions of law are determined to be findings of fact, they will be deemed to have been set forth herein as findings of fact.

Dated: ___, 1994

RANDALL J. NEWSOME
U. S. Bankruptcy Court Judge

Approved as to form.

/s/ Lynn Anderson Koller
LYNN ANDERSON KOLLER

APPENDIX F

IRVING J. KORNFIELD, ESQ. (Bar No. 033880)
HOWARD RUTTEN, ESQ. (Bar No. 164820)
KORNFIELD, PAUL & BUPP, P.C.
1999 Harrison Street, Suite 800
Oakland, California 94612
Telephone: (510) 763-1000

Attorneys for Tevis Thompson, Jr., Trustee

UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re **JAMES DELBERT McCONVILLE, CLARA MAE McCONVILLE, dba McCONVILLE ENTERPRISES,** **Debtors.**	**Case No. 93-44971 N** **Chapter 7**
TEVIS THOMPSON, JR., Trustee in Bankruptcy, **Plaintiff,** **vs.** **DAVID MARGEN and LAWTON ASSOCIATES, a California partnership,** **Defendants.**	**Adversary Proceeding No. 93-4541 N** **JUDGMENT AVOIDING TRANSFER** **(Filed Apr. 22, 1994)**

The trial in the above-captioned matter came on for hearing before the undersigned on April 4, 1994, Irving J.

Kornfield and Howard Rutten appearing on behalf of plaintiff Tevis Thompson, Jr. and Lynn Anderson Koller appearing on behalf of David Margen and Lawton Associates. The court having considered the evidence and argument of counsel, and having made findings of fact and conclusions of law;

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that plaintiff Tevis Thompson, Jr., Trustee in Bankruptcy, have judgment against David Margen and Lawton Associates, avoiding the transfer by the debtors to the defendants of that certain deed of trust recorded in the Alameda County Recorder's Office on August 13, 1993 as instrument number 93-290113.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that, this court having heretofore approved the sale of the property located at 725 South Elmhurst, Oakland, California free and clear of the lien of the defendants, if any, with such lien attaching to the proceeds thereof, said defendants shall have lien on the proceeds of the sale of the Property, and the Trustee shall hold such proceeds free and clear of any lien in favor of the defendants.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that plaintiff shall be awarded costs of suit.

Dated: ___, 1994 /s/ RANDALL J. NEWSOME
U. S. Bankruptcy Court Judge

Approved as to form.

/s/ Lynn Anderson Koller
LYNN ANDERSON KOLLER

APPENDIX G

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

IN RE: JAMES DELBERT MCCONVILLE, *Debtor.*	No. 95-15122
TEVIS T. THOMPSON, JR., Trustee, *Plaintiff-Appellee,* v. DAVID MARGEN; LAWTON ASSOCIATES, *Defendants-Appellants.*	D.C. No. CV-94-03308-FMS **ORDER** (Filed May 27, 1997)

Before: BROWNING and NOONAN, Circuit Judges, and MERHIGE* District Judge

The panel as constituted in the above case has voted to deny the petition for rehearing. Judge Browning voted to reject the suggestion for rehearing en banc and Judge Noonan recommended rejection.

The full court has been advised of the suggestion for en banc rehearing, and no judge of the court has

---

* Judge Merhige was unable to participate.

requested a vote on the suggestion for rehearing en banc. Fed. R. App. P. 35(b).

The petition for rehearing is denied, and the suggestion for a rehearing en banc is rejected.